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Testimony
for the Senate Finance Committee
In **SUPPORT** of

Senate Bill 164 – Insurance – Annuities – Nonforfeiture – Interest Rate

January 26, 2022

The League of Life and Health Insurers of Maryland Inc. supports Senate Bill 164 and urges the committee to give the bill a favorable report.

Individual deferred annuities are a popular option for consumers saving for retirement. In 2019, there were about 31 million such annuities in force, with about 1.6 million issued that year; it is a competitive market within our industry, and we compete largely with banks' Certificates of Deposit (CD).

Like CD's, these annuities are very conservative, with their funds predominantly in bonds, not stocks The National Association of Insurance Commissioners (NAIC) has long had a model law establishing the minimum nonforfeiture rate an insurer must use in calculating what to pay an annuitant who surrenders (forfeits) his annuity. Before this go-round, the NAIC last revised its model in 2003, setting 1% as the minimum (down from 3%, which reflected the days of double-digit interest rates) to reflect the huge drop in bond rates that began in the late 1990s and intensified poist-9/11.

The NAIC approved this latest change dropping the minimum rate from 1% to .15%, in December, 2020 (report included); the issue first went to the NAIC's Life Actuarial Task Force (LATF), then to its (A) Committee and then to the full NAIC.

LATF is a group of actuaries who studied the 1% minimum requirement in the context of the current economic environment and determined it is not sustainable. It considered new rates ranging from 0% (which had been our preference, with insurers noting negative interest rates in

the European markets) to .5% and came to .15%. It arrived at this after considering its dual objectives of consumer protection and a robust market; its concern (and ours) is prospective, with considerable uncertainty of where bonds are going. Insurers and the NAIC noted that bond rates have dropped considerably in the last few years – hence the attention to this.
The NAIC rate is the floor; insurers ***can and do*** offer higher percentages. LATF and the NAIC will have it under ongoing review, too.

But an unduly high minimum will limit product options and enhancements and possibly raise costs of these annuities – if you have to guarantee a nonforfeiture rate that exceeds the bond rates of the moment, you have to raise your own costs and limit options and benefits.

These amendments cannot be applied to contracts retrospectively and that was not the NAIC's intent in drafting and adopting them. It would ***not*** amend existing contracts. New products containing these new rates would still have to be approved by the Maryland Insurance Administration. Already in-force contracts will maintain their 1% minimum interest rate guarantee in calculating the nonforfeiture value.

Also, to be clear this interest rate change only applies to the return of principal when you turn in your annuity early. It does not impact the benefits that an annuity owner who has not forfeited their annuity would receive.

Passage of this legislation will mean that Maryland will join the vast majority of states that will enact the NAIC model in 2021. We urge a favorable report on SB 164.

NAIC GCC Public Summary Annuities.pdf
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National Association of Insurance Commissioners (NAIC)

Group Capital Calculation (GCC)

12/10/2020

Introduction

The National Association of Insurance Commissioners (NAIC) began development of the Group Capital Calculation (GCC) in late 2015 following extensive deliberation on potential valuation models and methodologies. The GCC is a natural extension of work state insurance regulators had begun, in part driven by lessons learned from the most recent financial crisis, to better understand an insurance group's financial risk profile for the purpose of enhancing policyholder protections. State insurance regulators already exercise their legal powers to obtain any information regarding the capital positions of affiliated business entities. However, there has not been a consistent or coherent analytical framework for evaluating such information and monitoring trends. As such, the GCC is designed to meet this need, delivering financial solvency regulators a panoramic, transparent view of the interconnectedness, business activities, and underlying capital support for an insurance group.

The GCC uses a bottom-up aggregation approach, accounting for all available capital/financial resources, and the required regulatory capital based on the valuation of assets and liabilities of the various corporate entities, including insurers, financial and non-financial businesses. The GCC, and related financial reporting, will provide comprehensive accounting and transparency to state insurance regulators, making risks more easily identifiable and quantifiable. Importantly, the GCC will complement existing group supervisory tools already available to state insurance regulators, such as the *Form F Enterprise Risk Report*[1], the *Own Risk and Solvency Assessment Summary Report*[2] and the *Form B Holding Company Filings*[3]. Altogether, the GCC will deliver an important set of information and capital ratio to facilitate earlier engagement with company management regarding potential business operations of concern and communication with other insurance regulators.

The GCC was adopted by the NAIC members in December 2020 after field testing in 2019 with more than 30 U.S. based firms, including property & casualty, life, and health insurers. Post field testing revisions were incorporated during 2020 based on multiple comment periods. In December 2020, revisions to the *Insurance Holding Company System Model Act* (#440) and supporting *Insurance Holding Company System Model Regulation* (#450) were adopted by the NAIC members. The revisions provide regulatory authority for a confidential filing process and include provisions addressing what

[1] *Insurance Holding Company System Model Act* (#440) and supporting *Insurance Holding Company System Model Regulation* (#450) require the annual filing of an Enterprise Risk Report (Form F) which requires the disclosure on material risks within the insurance holding company system that could pose enterprise risk to the insurer

[2] Risk Management and Own Risk and Solvency Assessment (ORSA) Model Act (#505) require the annual filing of an ORSA Summary report that includes 1) Description of the Insurer's Risk Management Framework; 2) Insurer's Assessment of Risk Exposure; and 3) Group Assessment of Risk Capital and Prospective Solvency Assessment

[3] *Insurance Holding Company System Model Act* (#440) and supporting *Insurance Holding Company System Model Regulation* (#450) require the annual filing of an Registration Statement (Form B) which includes, among other items, the annual financial statements of the ultimate controlling person in the insurance holding company system and all of its affiliates and subsidiaries

groups must file the GCC. The goal is to have the revisions enacted or promulgated in all states by November 2022.

The GCC Aggregation Methodology

As described above, the GCC is an aggregation or grouping of the available financial resources and calculated required capital of all material legal entities in an insurance group.

1) **U.S. Insurers** – The available capital/financial resources of U.S. domiciled insurers is determined by statutory accounting principles (SAP) as defined by state law and the NAIC *Accounting Practices and Procedures Manual*, which defines assets, liabilities, and in-turn net available capital/financial resources, sometimes referred to as policyholder surplus. The calculated capital for these insurers is established in state law that requires these insurers to maintain minimum capital based on the applicable NAIC *Risk-Based Capital formula* and is calibrated at 200% x ACL level

2) **Non-U.S. insurers** – Similar to the available capital/financial resources and calculated required capital of U.S. insurers, the available and calculated capital of non-U.S. insurers is determined by reference to the home jurisdiction's capital requirements. While most non-U.S. jurisdictions do not possess the same level of industry specific technical guidance, as included in the NAIC *Accounting Practices and Procedures Manual*, all jurisdictions have established accounting standards that insurers are required to follow to determine available capital/financial resources. In some cases, this represents local Generally Accepted Accounting Principles (GAAP), which may or may not be consistent with International Financial Reporting Standards (IFRS). In most cases the GCC utilizes the available capital/financial resources and home jurisdictions' capital requirement. The NAIC has adopted the concept of scalars for non-U.S. insurers, which adjusts both available and calculated capital to produce comparable measures for risk which can be aggregated into the group-wide measure. However, for now, a placeholder methodology for scalars is being applied in sensitivity analysis. Additional methodologies for scaling are being explored for eventual inclusion of a selected methodology in the calculation. In certain cases where risk sensitive capital requirements are not in place, an equity-based charge is applied.

3) **U.S. Captive Insurers**[4] – The available capital/financial resources of U.S. captive insurers is defined by the state law or regulation. With respect to calculated capital, the GCC utilizes the applicable Risk Based Capital (RBC) formula for captives.

4) **U.S. Insurers Not Subject to RBC**-Some types of U.S. insurers are not subject to an RBC formula (e.g. Financial Guaranty Insurers, Title Insurers). For these entities, the available

[4] US Captive Insurers that are used to self-insure the group are not treated as insurers but rather as non-regulated business entities.

capital/financial resources is determined by reference to state law and the NAIC *Accounting Practices and Procedures Manual*. However, since an RBC formula does not exist, calculated capital is determined by reference to the state minimum capital requirements set out in state law or regulation.

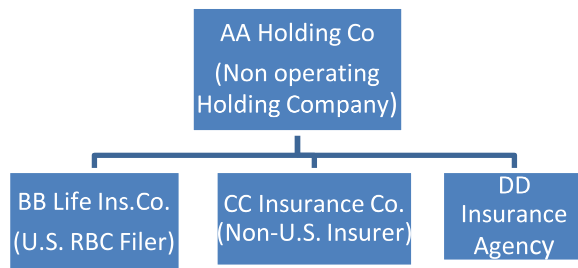
5) **Non-Insurer Financial Entities Subject to Regulatory Capital Requirements**-Non-insurers such as banks are subject to their own valuation methods (typically GAAP) and their own regulatory capital requirements (e.g. OCC, Federal Reserve, FDIC, or other requirements for banks).

6) **Non-Insurer Financial Entities- Not Subject to Regulatory Capital Requirements** -The GCC requires available capital/financial resources and calculated capital to be gathered for all non-regulated business entities that could pose a material risk to insurers. Financial entities tend to carry more risk, this specifically includes entities such as asset managers or investment advisors that provide services outside the group. The GCC will utilize the valuation used by such legal entities (typically U.S. GAAP) and a calculated capital based upon applying a risk factor, adjusted for the level of risk, to average gross revenue over the most recent three-year period. The level of risk is determined by the filer using material risk principles described in the instructions for the GCC and that determination is reviewed by the lead-State.

7) **Non-Insurer / Non-Financial Entities (Including Non-Operating Holding Companies)**-Non-insurance Non-financial entities in the group may be excluded from the GCC upon request by the filer and acceptance by the lead-State if they do not pose material risk. Material risk is determined by the filer using risk principles described in the instructions for the GCC and that determination is reviewed by the lead-State. The GCC will utilize the valuation used by such legal entities (typically U.S. GAAP) and a calculated capital based upon applying an average post-covariance risk factor calculated from aggregate RBC data for each insurer type. The industry factor will be based on the predominant underwritten business within the group (i.e. life and annuities – 10.5%, property and casualty – 9.5%, or health – 3.5%)

The GCC uses an aggregation and elimination approach, where each of the above legal entities' available capital/financial resources and calculated capital are combined, then eliminations are utilized to prevent any double counting of available capital/financial resources or calculated capital. The following example illustrates the use of eliminations for both available capital/financial resources and calculated capital, however in practice the GCC only requires the insurers owned by an insurance company to be "de-stacked" and the capital required for DD Insurance Agency would already be included in the RBC of AA Insurance Company However, its shown herein as part of the eliminations for simplicity purposes.

EE Insurance Group (EEIG)



EEIG Financial Information

Entity	Total Available Capital	Minimum Regulatory Capital
AA Holding Company	50.0 Million	0[2]
BB Life Insurance Company	30.0 Million	3.0 Million[3]
CC Insurance Company	6.0 Million[1]	1.6 Million[3]
DD Insurance Agency	2.0 Million[1]	0[2]

[1] For Non-RBC filers this is regulatory available capital or stockholder equity
[2] There is no regulatory capital for these entities when owned by a non-regulated entity. Calculated Capital is added @ 10.5% x stand-alone ARC
[3] Authorized Control Level (ACL) RBC or Prescribed Capital Requirement for non-U.S. insurers

Calculation of ARC

Entity	TAC	Less: Subs' TAC	Adjusted TAC
AA Holding Co.	50.0M	(38.0M)[1]	12.0M
BB Life Insurance Co.	30.0M	0	30.0M
CC Insurance Co.	6.0M	0	6.0M
DD Ins. Agency	2.0M	0	2.0M
ARC (EEIG Group Total)			**50.0M**

[1] Amount of TAC for Subs as follows: (30.0M + 6.0M + 2.0M)

Calculation of MRC

Entity	ACL or Calculated Capital[1]	Less: Subs' Calculated Capital	Adjusted Calculated Capital	Multiply by 2.0[3]	MRC
AA Holding Co.	6.07M	(4.81M)[2]	1.26M	NA	1.26M
BB Life Ins. Co.	3.0M	0	3.0M	6.0M	6.0M
CC Insurance Co.	1.6M	0	1.60M	NA	1.6M
DD Ins. Agency	0.21M	0	.21M	NA	0.21M
MRC Total					**9.07M**

[1] Estimated post covariance factor of 10.5% @ CAL x ARC per GCC added for AA Holding Co. and DD Ins. Agency
[2] Amount of Calculated Capital for Subs as follows: (3.0M +1.6M + .21M)
[3] Applies to U.S. insurer only to increase level to Company Action Level (CAL) RBC

In the above example, available capital/financial resources are referred to as available regulatory capital (ARC) and total authorized capital (TAC[5]) and minimum calculated capital is referred to as minimal regulatory capital (MRC) and authorized control level (ACL[6]). The GCC will allow non-insurance / non-financial entities owned by RBC filers in the group to remain within the available capital and regulatory capital so no eliminations are required for these entities. As shown, since AA Holding Company owns each of the other business entities in the organizational chart, $38 million (which is the amount of available capital/financial resources in the subsidiaries of AA) is eliminated from the TAC column since accounting methods include those as an asset on AA Insurance Company's balance sheet. Also, the GCC includes capital calculations for AA Holding Company and DD Insurance Agency as part of the MRC in addition to the regulatory capital already included for the insurance subsidiaries. The MRC of the subsidiaries is eliminated from the parent's (AA Holding Company) calculated capital. Therefore, in this example $4.81 million of calculated capital is eliminated from the MRC. Finally, the MRC of U.S. insurance subsidiary is multiplied by 2 in order to reflect Company Action Level (CAL) RBC as required in the GCC.

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[5] Terminology used in RBC for available capital/financial resources
[6] Terminology used in RBC for calculated regulatory capital

Deriving the Group Capital Ratio & Related Items

The GCC methodology includes a limited adjustment for capital instruments after the aggregation and eliminations have been performed. This "on-top" adjustment for senior debt and hybrid[7] financial instruments represents an allowance for longer-term debt (maturity period of greater than five years) that is not already recognized as available capital/financial resources under all known accounting principles (SAP, U.S. GAAP or IFRS) but may have some value to the group under the U.S. insurance regulatory requirements where dividends must be reviewed or approved[8] by the state. The GCC gives some credit (addition to reported available capital/financial resources) to this debt.

While not included in the group capital ratio, certain other elements will also be captured in a Sensitivity Analysis tab in order to provide lead-state[9] regulators with an additional view of the impact of certain "what if" scenarios related to either adherence to or variances from the U.S. insurance regulatory framework that are part of the group capital ratio. These include:

- **GCC overall sensitivity analysis –**The overall GCC ratio will be presented at 300% x ACL level to reflect a trend-test level view.
- **Prescribed & Permitted Practices**-These represent differences between the company's required available capital/financial resources due to valuation differences between state law/state practices and the NAIC *Accounting Practices and Procedures Manual*
- **Foreign Insurer Capital Requirements Scaled** – This information shows the amount of foreign insurer capital calculations scaled by applying scalars using the Excess Relative Ratio as described in the GCC instructions for all non-U.S. jurisdictions where scalar data is available.
- **Debt Classified as "Other"** – This will show an additional capital allowance for certain debt other than senior debt and hybrid capital instruments.
- **Adjustment for captives other than XXX/AXXX -** An adjustment is made for the assets included in a captive or an entity not required to follow the statutory accounting guidance in the *Accounting Practices and Procedures Manual*.

Use of the Group Capital Ratio

[7] Debt issuances that receive an amount of equity credit from rating agencies.
[8] Supervisory approval of ordinary dividends is met if the supervisor has in place direct or indirect supervisory controls over distributions, including the ability for the supervisor to limit, defer and/or disallow the payment of any distributions should it find that the insurer is presently, or may potentially become, financially distressed.
[9] The operations of an insurance group often are not limited to one domestic state. The lead state is generally considered to be the state that "takes the lead" with respect to conducting group-wide supervision within the U.S. solvency system. The concept of lead state is not intended to relinquish the authority of any state, nor to increase any state's statutory authority. It is intended to facilitate efficiencies when one state coordinates the regulatory processes of all states involved

The resulting group capital ratio will be utilized by regulators to evaluate the capital position of the group. However, the benefits of the GCC far exceed the single figure that the ratio represents. The GCC (and other aggregation approaches) provide relevant information on available and calculated capital of the material entities in the group, which will assist in understanding how capital is distributed across an entire group. Most importantly, although certain non-insurance / non-financial entities may be excluded from the group capital ratio itself, the GCC includes a full inventory of companies and corresponding selected financial information (net income, premiums, dividends, liabilities, debt, etc.) that can be used to review trends by state regulators. This will assist with identifying negative trends and which suggest risk is increasing, thereby providing an early warning signal to regulators. By comparison, consolidated reporting utilizes a top-down approach that typically does not provide the same level of detail as to the location of capital within. Also, it can rely on valuation approaches that differ from those utilized by regulators to evaluate the solvency of their regulated institutions, thereby making it less aligned with the objective of policyholder protection.

Future Work

It is anticipated that there will be additional data collection during 2021 and further input will be received, particularly with regard to scalars for non-U.S. insurers and the allowance for capital instruments. Going forward, the GCC template and instructions will be maintained in a similar manner as the Risk-based Capital formulas, whereby enhancements and adjustments will be developed, released for comment, and ultimately adopted by the NAIC members. The first formal filings of a GCC are expected to occur in 2022.